

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of David Schlesinger on April 24, 2006

DATED: May 25, 2006

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On April 24, 2006, Michael Schachter and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed David Schlesinger at the City Administration Building, 202 C Street in San Diego, in a conference room on the third floor. Johnny Giang and Wendy So from KPMG also attended the interview. Mr. Schlesinger was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with David Schlesinger, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

#### *Warnings*

Mr. Schachter informed Mr. Schlesinger that we are counsel to the Audit Committee and do not represent him or any employee. He advised Mr. Schlesinger that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee in the best interests of the City, not by Mr. Schlesinger personally. Mr. Schachter said we will create a report which may contain statements of interviewees, and this report will likely be provided to KPMG and ultimately the public. He said government agencies may view the report and may be provided with additional information so it is important to be truthful and accurate. Mr. Schlesinger asked Mr. Schachter if he will have the opportunity to see the memo so he can correct it. Mr. Schachter responded that the memo is not a transcript but rather our mental impressions and will not be provided to Mr. Schlesinger for him to correct. Mr. Schlesinger responded that he is here to provide facts as he sees them and would like to try to get the facts "in front of someone."

#### *Background*

Mr. Schachter asked Mr. Schlesinger to describe his professional background. Mr. Schlesinger said that he graduated from the naval academy in 1965 and received a BS and MA in civil engineering from Georgia Tech. He spent 25 years in the Navy dealing with facilities construction and combat engineering. He was a planning officer in the Navy's field division in San Diego from 1988-1990 and was the Department of Defense representative on SANDAG, a local planning agency, where he interfaced with San Diego. San Diego asked him to interview for a position working on the wastewater program upgrade including the Clean Water Program. The City Manager told him that it was a multibillion dollar program and that he

would have the opportunity to run it and put a staff together for it. He started work in July 1990 as Director of the Clean Water Program. In 1988, the City was sued by the EPA because Point Loma was not at acceptable clean water standards. The City agreed to a \$5-6 billion program to go to secondary treatment at Point Loma. Complex issues were involved including that the outfall at Point Loma was out of compliance with the State ocean plan. The City was facing a Federal lawsuit about the lack of compliance and the State of California joined the suit.

He volunteered that the City hierarchy is such that people work their way up and it is stratified. He was an anomaly because he did not work his way up but rather was hired from the outside and he felt that some people did not like the fact that an outsider was hired for his position. He hired staff and created an organization by hiring both within and outside San Diego government.

### ***Reporting Structure***

Mr. Schachter asked Mr. Schlesinger to describe his reporting structure. Mr. Schlesinger reported directly to City Manager Jack McGrory. He said that McGrory made decisions quickly. Mr. Schlesinger stated that McGrory agreed with him that the City should go into the bond market in 1993. The City wanted the 1993 bonds to go well and they did a big road show that toured Chicago, Boston and New York, and included the City Auditor, City Attorney, Mayor, Councilwoman Stallings, and Pat Frazier (Deputy City Manager).

Mr. Schachter asked Mr. Schlesinger to explain the purpose of the road show. He said the road show's purpose was to convince potential buyers that the City was knowledgeable about the bonding process and this was particularly important given that the EPA court case was in the news.

### ***Job Responsibilities***

Mr. Schachter asked Mr. Schlesinger to discuss his job responsibilities. Mr. Schlesinger said that when he came to work for San Diego there was no financing plan in place to take Point Loma to secondary treatment. No wastewater bonds had been issued for twenty-five or thirty years. Since 1963, the system had been operational and was maintained and upgraded on a "pay as you go" basis. Roger Fromfelder of the water and wastewater departments told him to concentrate on the capital side of wastewater. Mr. Schlesinger came up with cost estimates and learned that secondary treatment would involve a large increase in sewer costs. In 1992, Mayor Golding had just been elected and she met with Mr. Schlesinger and told him she believed secondary treatment was not the right thing to do. He told the Mayor that there were good scientific reasons not to go to secondary treatment and they both determined that the City would not go to secondary treatment.

When the City took the position not to go to secondary treatment, the Judge overseeing the EPA court case, Judge Brewster, took more interest in the matter and wanted more information about treatment in San Diego. At that point, the Sierra Club became a broker in negotiations and floated the possibility that maybe the City did not have to go to complete secondary treatment if the City did water reclamation. This was a "good sell politically" because there was a drought at the time. The City provided the Court with a scientific basis to show that advanced primary treatment at Point Loma and building a robust water reclamation program

would ease the Judge's concerns. Schlesinger presented a program that would keep Point Loma at primary treatment with a major outfall extension and would involve building a series of reclamation plants. The City prevailed in the case and the Judge did not order secondary treatment but did order the reclamation plants to be built. The City lobbied for a 301(h) waiver and began building the program. The City had to enter "the market" for the money to build the reclamation plants.

### *Wastewater*

#### *The Participating Agencies*

Mr. Schachter asked Mr. Schlesinger to describe his involvement with the Participating Agencies ("PA's"). Mr. Schlesinger said that the PA's are the fifteen agencies that utilize the sewer system of San Diego but do not own it. In the mid-1990's, the contracts with the PA's were expiring and some PA's did not want to pay for plant upgrades. He spent time with the PA's and told them that no one could afford the upgrades on their own and therefore there needed to be a regional system and the PA's had to pay a proportional percentage of the upgrades. Some PA's were not paying and were in arrears but finally all of the PA's paid. The Judge's ruling that the City did not have to go to secondary treatment helped persuade the PA's to come to an agreement since they would no longer have to share costs for implementing secondary treatment at Point Loma. Mr. Schlesinger was able to obtain signed contracts from all of the PA's which extended for a 50-year period.

### *Right of Way*

Mr. Schachter asked Mr. Schlesinger to discuss the right-of-way issue. Mr. Schlesinger said he told McGrory that the City could not charge for right-of-way and that the rationale for the charge did not make sense. The fee involved giving \$50-100M of the Enterprise Fund to "somewhere else." For example, with the Fiesta Island Mitigation fees, the Enterprise Fund was assessed and the money went to the Park and Recreation Fund. The taxpayers got the right of way fee phased out.

### *The POS*

Mr. Schachter asked Mr. Schlesinger whether he was involved with the Preliminary Official Statement (hereinafter "POS") and Paul Webber (outside bond counsel from Orrick Herrington). Mr. Schlesinger replied that he worked on the POS and Webber was disclosure counsel. He described Webber as "great" and "excellent." Shari Sacks from Financing Services ran the POS meetings. The City did not have experience in selling big bonds. Mr. Schlesinger provided technical briefings at the POS meetings. The schedules and cost estimates were important and he provided a risk analysis of the bidding climate. Each person had an area to work on for the POS. Kelly Salt from the City Attorney's Office was assigned to the Wastewater Department and dealt with service level agreements. She attended most POS meetings and was the in-house bond disclosure expert. City Auditor Ed Ryan would sometimes sit in on the POS meetings. Mr. Schlesinger personally went to almost every POS meeting and had a lot of authority.

Mr. Schlesinger was shown Exhibit 1, a September 17, 1999 memo from William Hanley (Deputy Director for Contract Services, MWWD) to Dennis Kahlie (Utilities Finance Administrator) re: "Dennis Kahlie's memo of September 7, 1999." He recalled Darlene DeRose (outside financial consultant, Montague & DeRose). Mr. Schachter asked Mr. Schlesinger for his reaction to the document, in particular Section D. He replied that Section D led you to believe that the revenue program was not yet approved but getting close. He had received loans for two projects. In hindsight, if the State had thought the City had already implemented SBB, he would have been troubled by Section D. He did not answer the question asked in Section D. When asked by Mr. Schachter, he said that he never recalled discussions about withholding information and recalls "lots of discussing" about specific wording in the POS. He reread Exhibit 1 and said that it would lead you to believe the City had an approved revenue program.

#### ***Discussion of 218 at POS Meetings***

Mr. Schachter asked Mr. Schlesinger whether the Proposition 218 issue was dwarfed by the noncompliance issue. Mr. Schlesinger replied that it is true that Proposition 218 was a less significant issue. What finally got the City moving on the Cost of Service Study ("COS") was the City wanted to be sure to be in compliance with Proposition 218. He remembered that a lot of discussion took place about Proposition 218.

#### ***Discussion of Noncompliance at POS Meetings***

Mr. Schachter asked Mr. Schlesinger to describe the discussions concerning noncompliance at the POS meetings. Mr. Schlesinger replied that there was not a lot of discussion about noncompliance. He thinks he recalls bringing up the issue of noncompliance and receiving a response that it was "such a remote possibility" that it did not need to be disclosed. He recalled Sacks relating that disclosing the noncompliance would cause the bond interest rate to increase. Bond counsel attended the POS meetings and Schlesinger believed that everyone in attendance knew about the noncompliance and the status of the revenue plan. He commented that the same "disallowed" language appeared in all four POS. He noted that the "disallowed" language was a true statement.

Mr. Schachter asked Mr. Schlesinger if he actually remembered any discussion about noncompliance. He replied that he did not remember but it is a combination of his belief that such a discussion took place plus the weekly briefings he had with the City Manager that leads him to believe that such discussions did take place.

Mr. Schachter asked Mr. Schlesinger whether Webber was aware of the noncompliance issue. He believes that Webber was aware of the noncompliance issue. He had a close relationship with Webber and "told him everything he needed to know." Webber did an excellent job. He "at least had mentioned" to Webber the letter from Ron Blair (Revenue Program Specialist, State Water Resources Control Board). Webber's expertise was far greater than that of Salt, Frazier, and Sacks. Mr. Schachter asked Mr. Schlesinger if he recalled a discussion with Webber about the noncompliance. He did not recall such a conversation with Webber. Mr. Schachter asked Mr. Schlesinger if he recalled discussing the issue of noncompliance with Salt. Mr. Schlesinger said he did recall telling Salt of the noncompliance and his concerns regarding the possibility of losing the grants. At the time, the City was still drawing grants and the grants were audited so the City would be "on the hook" for a long time.

Mr. Schachter asked Mr. Schlesinger if he would have said that the noncompliance issue was no big deal. He replied that he would not have said that the noncompliance was no big deal. He volunteered that he carried the 1994 Blair letter around with him to remind him of the noncompliance issue.

### *Knowledge of the Rate Case*

Mr. Schachter asked Mr. Schlesinger to discuss his knowledge of the rate case. Mr. Schlesinger described the rate case as a "hugely political issue" and said that the planned increase was 6%. When he first began work as head of the Metropolitan Wastewater Department (hereinafter "MWWD"), he wanted to ramp up rates very high initially and felt that such a ramp up would allow him to do more projects. However, politically, the rates were not acceptable and thus 6% became the rate case. Because the rate case was only 6% he had to plan carefully and he was concerned about running out of money. Ted Bromfield from the City Attorney's Office provided him with an outlook regarding the chance of the City prevailing in court and receiving a legislative waiver, which helped him budget appropriately.

Mr. Schachter asked Mr. Schlesinger to explain what a rate case is. Mr. Schlesinger said a rate case is what is put together to anticipate future rate increases. It projects out multiple years and recommends the size of the bond issuance and lists projects to be funded. The rate case is the key document needed to obtain a bond issuance, while the COS discusses the distribution of costs.

Mr. Schlesinger was shown Exhibits 2, 3, 4, 5, 6 and 7:

- Exhibit 2 is a December 14, 1994 memo from Schlesinger to Distribution List re: "Support Requirements for Strength-based Billings for the Participating Agencies."
- Exhibit 3 is a February 8, 1995 letter from Schlesinger to Blair re: "Revenue Program Review – City of San Diego, Clean Water Grant Project No. C-06-1092."
- Exhibit 4 is an April 5, 1995 memo from Hedy Griffiths (Supervising Management Analyst, Agency Contracts, MWWD) to Alan Langworthy (Deputy Director, MWWD) via Charles Mueller (Financing Services Manager) re: "Selection of COD v. BOD as Basis for Strength-based Billing of PA's."
- Exhibit 5 is a June 9, 1995 letter from Blair to Schlesinger re: "Revenue Program Review – City of San Diego, Clean Water Grant Project No. C-06-1092 and State Revolving Fund Loan Project No. C-06-4168."
- Exhibit 6 is a June 12, 1995 letter from Griffiths to Blair re: "Revenue Program Review Update No. 1 City of San Diego, Clean Water Grant Project No. C-06-1092."

- o Exhibit 7 is a July 31, 1995 letter from Schlesinger to Blair re: "Revenue Program Review."

### ***Compliance with State Requirements***

Regarding Exhibit 2, a December 14, 1994 memo from Schlesinger to Distribution List re: "Support Requirements for Strength-based Billings for the Participating Agencies," Mr. Schachter asked Mr. Schlesinger whether he was aware that the City was not in compliance with State requirements. Mr. Schlesinger said that Blair sent him a letter months before Exhibit 2 which was transmitted to the City Manager. The letter said that the grants were at risk and State Reporting Fund ("SRF") loans were also at risk if the City did not adopt a compliant rate structure. He spent a lot of time trying to obtain Federal grants. He met with Blair several times in Sacramento. The City was not a player in SRF funds so he pushed to raise the level of SRF eligibility to \$50 million. In 1994-1995 the City was charging based on flow and TSS. The grant requirements said that the City had to charge based on the strength of organics, BOD/COD. Mr. Schlesinger told McGrory several times that there was a requirement to charge for organics for retail customers ("City users") as well as the PA's.

### ***Strength Based Billing***

Mr. Schachter asked Mr. Schlesinger if the State was aware of the City's noncompliance. Mr. Schlesinger replied that a decision was made to go to SBB and he believes it was discussed with the State. It was clear to the State that the City would start implementing organics starting with the PA's. He thinks the State knew of this decision. It is possible that Blair did not know; however, but he said that Blair received annual audit reports which have a section on revenue regarding how City users were being billed. Implementing SBB was revenue neutral and allocated billing more properly among constituents.

Mr. Schachter asked Mr. Schlesinger why SBB was first implemented for the PA's rather than for City users. Mr. Schlesinger said it was easier to start with the PA's because there was a single connection point and it was easier to take such samples. The City itself had hundreds of thousands of connection points. There was an understanding that after the PA's were implemented and any problems solved, it would be quicker to convert San Diego.

Mr. Schachter asked Mr. Schlesinger why it took so long to implement SBB for City users. Mr. Schlesinger replied that the City wanted to do something as quickly as possible so as not to lose the grants. Issues can take a long time to resolve in San Diego. He provided the example of winter water usage. An issue arose as to how to estimate the contribution from individual homes for winter water usage, which quickly became a political issue and it took months for the government to resolve the issue of how these costs would be estimated.

Regarding Exhibit 6, a June 12, 1995 letter from Griffiths to Blair re: "Revenue Program Review Update No. 1 City of San Diego, Clean Water Grant Project No. C-06-1092," Mr. Schlesinger said he approved it. The City was moving ahead and implementing SBB with the PA's as soon as possible but also was doing it for the City. Implementing SBB for the City was much more complicated and the City had to do a COS to determine how to do it. He "distinctly" remembered that it was the City's plan to implement SBB for the PA's before doing so for the City. He recalled that two of the PA's thought they were being over-billed and could

get a better deal if SBB was implemented. He expressed concern to McGrory that the SRF grants and loans were at risk and that there was a need to go to SBB for all users, which spurred action.

Mr. Schlesinger was shown Exhibits 8-18:

- Exhibit 8 is a December 2, 1996 email from Langworthy re: "Kelco-Forwarded," attaching a November 27, 1997 email from SHE@SDDPC.sannet.gov to "Jack, Coleman, Dave S., Alan L, Charles Y, Kelly S. and Shari Sacks" re: "Kelco Discount."
- Exhibit 9 is a February 13, 1997 email from Hanley re: "Kelco sewer bill reductions."
- Exhibit 10 is an April 7, 1997 email from Schlesinger re: "Kelco Meeting April 4 '97."
- Exhibit 11 is an April 25, 1997 email from Schlesinger re: "Kelco Incentive to Reduce Sewer Discharge Strength."
- Exhibit 12 is a July 8, 1997 letter from Jim Putman (State Water Resources Control Board) to Schlesinger re: "Facilities Plan Approval, City of San Diego, Point Loma Digesters 7 and 8, and Gas System Upgrade, State Revolving Fund (SRF) Loan No. C-06-4383-110."
- Exhibit 13 is a July 31, 1997 memo from Hanley to Distribution re: "Draft Cost of Service Study."
- Exhibit 14 is an August 8, 1997 memo from Hanley to Coleman Conrad (Deputy City Manager) re: "Implementation of Strength Based Billing."
- Exhibit 15 is an August 14, 1997 email from Langworthy re: "Draft Cost of Service Study."
- Exhibit 16 is an August 18, 1997 letter from Mick Gammon (Supervising Management Analyst, MWW) to Farouk Ismail (State Water Resources Control Board) re: "State Revolving Fund Loan Program, City of San Diego Applications Revenue Program Issues."
- Exhibit 17 is a September 9, 1997 fax cover sheet from Corinne Smith (Water Department) to Bromfield re: Kelco's sewer classification, attaching an August 25, 1997 letter from Schlesinger to David McKinley (Kelco) re: Kelco's sewer classification.
- Exhibit 18 is a June 2, 1997 email from Schlesinger to Charles Yackly (Acting Director, Water Department) bccing Langworthy re: "Kelco Sewer Line."

Regarding Exhibit 8, a December 2, 1996 email from Langworthy re: "Kelco-Forwarded," attaching a November 27, 1997 email from SHE@SDDPC.sannet.gov to "Jak, Coleman, Dave S., Alan L, Charles Y, Kelly S, and Shari Sacks" re: "Kelco Discount." Mr. Schlesinger said that "Steve" is Steve Hogan, who sent out bills for the Wastewater Department. Yackly was the "financing guy" for the Water Department and Sacks was the financial services director and ran the POS meetings. George Loveland was the Deputy City Manager for Water.

Regarding Exhibit 12, a July 8, 1997 letter from Putman to Schlesinger re: "Facilities Plan Approval, City of San Diego, Point Loma Digesters 7 and 8, and Gas System Upgrade, State Revolving Fund (SRF) Loan No. C-06-4383-110," Mr. Schachter asked Mr. Schlesinger to explain the document. He said that it is a standard document saying that the City is in compliance with getting SRF loans. The City had started the process of implementing SBB for City users but that the process became "blurred." There were no interim milestones and the State assumed that since the City was starting implementation, it would finish it. It was easy for the State to pick up the phone and ask if SBB was being done but the State did not do so. The State continued to provide grants and loans to the City.

Regarding Exhibit 14, an August 8, 1997 memo from Hanley to Conrad re: "Implementation of Strength Based Billing," Mr. Schlesinger said that SBB was set for implementation for Fiscal Year 1999, which was the year after it was implemented for the PA's. When asked, he said that he did not recognize the handwriting on the second page. Regarding Exhibit 16, an August 18, 1997 letter from Gammon to Ismail re: "State Revolving Fund Loan Program, City of San Diego Applications Revenue Program Issues," Mr. Schachter asked Mr. Schlesinger to discuss the referenced meeting. He replied that Gammon attended the meeting and it dealt with SRF financing issues. Ismail was not in the same office as Blair but had "lots of interface with Blair." He cannot recall if Schlesinger participated in the meeting. The meeting was specifically called to discuss SRF for the South Bay Reclamation Plant. When asked by Mr. Schachter, he said that he did not know why only SBB for the PA's was mentioned in Exhibit 16.

### *The COS*

Mr. Schachter asked Mr. Schlesinger to describe what happened with the 1998 COS. Mr. Schlesinger said that the COS was finished in 1998 and he gave briefings to Conrad about the COS. He also briefed McGrory about the table in the COS that showed the average single family bill would go down 20% but that restaurants and Kelco would see their fees increase significantly. The billing change became a "flashpoint" and Kelco kept threatening to move. Kelco representatives told Schlesinger that he was causing jobs to be lost. When the final COS was ready, he wanted it to be transmitted to the Council as soon as possible. There were options because all COS studies have some subjectivity. Financial Services, in particular Frazier, did not want the COS to go to the Council. He noted that the COS was a report originating from Financial Services.

Mr. Schachter asked Mr. Schlesinger about his statement that Frazier did not want the COS to go to the Council. Mr. Schlesinger did not recall a direct conversation with Frazier but he did recall Frazier, Sacks, and maybe Mary Vattimo (City Treasurer) not wanting the COS to go to the Council. He briefed one councilmember in private, Christine Kehoe, and he asked for a City Attorney opinion regarding Proposition 218. From a technical standpoint, the COS needed to be done so that characterizations could be allocated as well as physical sampling could



be done. Concerns were raised that the COS had inaccuracies but he was ready to vouch for it. It was his impression that the COS was stalled because of the bond issuances. The COS was an "anti-business" study and the culture in the City was that the City did not want to be seen as anti-business. The goal of Frazier's Financial Services Department was to get the bond issued at the lowest possible interest rate for the betterment of the City. If controversies were going on, the interest rate would be affected. Issues like the Federal court case contributed to uncertainty.

Mr. Schlesinger was shown Exhibit 19, an October 1999 memo from Loveland to the Mayor and City Council transmitting the May 1998 COS. He said the memo was written by Kahlie. Mr. Schachter asked Mr. Schlesinger if he felt the memo was accurate. Mr. Schlesinger said that he did not believe the memo was accurate and it is not what the study said. The memo seems to say that the COS was done to comply with Proposition 218 but he said there was no mention that its purpose was to deal with the rate case.

Mr. Schlesinger was shown Exhibit 20, an October 19, 1999 email from Schlesinger to Loveland and Larry Gardner, cc'ing Hanley, Kahlie, Penny Culberth-Graft and others, re: "Water and Sewer Cost of Services Studies." Larry Gardner was Director of the Water Department. Mr. Schlesinger volunteered that this is the first time he is aware of the results of the COS being shared. At this point, the COS had been completed a year earlier. Mr. Schachter asked Mr. Schlesinger to explain Exhibit 20. He said that he discussed the COS with Councilwoman Kehoe who had been told about the May 1998 COS in October 1999. He identified Craig Adams as Kehoe's "guy" assigned to water issues. Myrna Zambrano was Kehoe's Chief of Staff. He noted that Adams probably called him. Kehoe asked him about the COS. He is pretty sure she did not have a copy of the COS at the time. Kehoe knew that residential rates would decrease and commercial rates would increase. She told him that the City should "give the little guy a break." Kehoe felt that businesses should pay their fair share. She also felt that sewer rates hurt residents more than businesses. Mr. Schachter asked Mr. Schlesinger if he recalled Adams saying the October, 1999 memo was misleading. He did not remember Adams saying that the cover letter was misleading. Mr. Schachter asked Mr. Schlesinger to explain what he meant by "damage control." By "damage control" he meant that Kehoe wanted to know why the COS was not released and he did not want to say it was Loveland's or Financing Service's fault. He had the perception that Financing Services and maybe the City Manager did not want the COS released because it was anti-business. The COS was "political." He said Financing Services did not like political firestorms because they create uncertainty in the bond market.

Mr. Schachter asked Mr. Schlesinger if he knew whether Kehoe understood the impact of the bond disclosures. Mr. Schlesinger said he doubted whether Kehoe would understand the bond disclosure issues and the potential impact of them. Mr. Schlesinger did not think she tied in the bond issuance. He did not think the Council wanted to deal with the COS at the time. He did not talk with Kehoe about the bond disclosure issue. Kehoe was "so angry" because the COS was so old.

### *Awareness of Noncompliance*

Mr. Schachter asked Mr. Schlesinger how well known it was among the members of the Council that the City was out of compliance with the State's requirements. Mr. Schlesinger said he had contacts with Councilman Harry Mathis and Councilwoman Valerie Stallings regarding SBB and briefed both of them on the issue. Mathis and Stallings wanted to know if a political fire storm was brewing and he told them that yes, there was one brewing, because of the grant issues. Mr. Schachter asked Mr. Schlesinger if he briefed any Council members other than Stallings and Mathis about the COS. Mr. Schlesinger briefed Councilman Wear about the COS, in private. Wear was much more interested in complaining about a pump station being built at Point Loma.

Mr. Schachter asked Mr. Schlesinger who else in City government knew of the noncompliance. Mr. Schlesinger said he did not recall communications with Frazier but had the impression that Frazier, Sacks, and maybe Vattimo with "some play by Ryan" did not want the COS to go to Council. It was "clear" that they did not want the COS published. People knew the COS was going on and it was unusual not to go to Council. The COS had to be approved by the Council for funding. Two more COS's were done later but it was not until "major pressure from Sacramento" that the COS was finally released. He noted that he did not have a good relationship with Frazier.

Mr. Schlesinger was shown Exhibit 21, a January 22, 1999 e-mail from Schlesinger to GIL re: "Discussions with Councilmember Stallings Jan 21 '99." Mr. Schachter asked Mr. Schlesinger to explain what he was documenting in the e-mail. He said that he was going to a water reuse meeting in Los Angeles. Stallings accompanied him and was a good supporter of his wastewater program and of the bond sale. They talked of things of a political nature. He probably told her about the COS and its imbalance between residents and business. It was a big political issue. She responded that biotech was concerned about SBB.

### *Kelco*

Mr. Schachter asked Mr. Schlesinger to discuss Kelco's involvement in the rate structure. Mr. Schlesinger said that the first COS was done by PinnacleOne and that he went to almost every meeting. McKinley from Kelco was a "thorn in the side of the process" and disrupted meetings. The efforts of Kelco were a continual effort to delay the citizen's group and were one of the causes of the delay in implementing SBB. Kelco was one of the largest contributors of organics in San Diego. Mr. Schlesinger said that there were rumors that Kelco was active in lobbying the City. He met with McKinley and his bosses and throughout Kelco's top leadership. The company did not want the COS published or implemented. Kelco went out of their way to belittle other constituents on the stakeholders' group and advocated the functional design approach instead of the COS's recommendations.

Mr. Schachter asked Mr. Schlesinger to discuss Exhibit 9, a February 13, 1997 email from Hanley re: "Kelco sewer bill reductions." Mr. Schlesinger said he was not in favor of giving money to Kelco. It seemed "to happen too fast." He asked for an attorney's and auditor's opinion as to whether it was legal to do. He had concerns about paying money up front for an industry that the City was under-billing. Even before SBB became a big issue, Kelco wanted credits for installing pretreatment equipment. He did not recall the City providing credits

or support for anyone else. He stated that if it was being done for Kelco, why not for others and questioned the legal basis for doing so. The Kelco situation seemed to be representative of the lobbying clout of Kelco. He said the \$300K referenced in Exhibit 9 was a loan. He had a long conversation with Bromfield and Bromfield was heavily involved in the issue. He wanted something in writing that it was legal. There were thousands of industries in San Diego and Kelco was asking for favorable treatment. He assumed that a check was cut from the Enterprise Fund directly to Kelco, which was unusual. The Kelco treatment facilities were not even on City property but instead were on the perimeter of Kelco's facility. He was very concerned and told Bromfield that he wanted an attorney and auditor opinion. He is sure no interest was charged to Kelco. Mr. Schlesinger did not agree with giving a credit unless Kelco reduced their flows and did not agree with giving them a loan either. Bromfield was "very good" and he felt comfortable with Bromfield's opinion.

Regarding Exhibit 18, a June 2, 1997 email from Schlesinger to Yackly, bcc to Langworthy, re: "Kelco Sewer Line." Mr. Schachter asked Mr. Schlesinger if he felt it was a proper use of sewer funds. Mr. Schlesinger said he did not think it was a proper use of the sewer revenue fund. He did not feel it was appropriate to use sewer enterprise funds to give money to a company in anticipation that it would reduce loading. It may have made sense if the sewer system was at 99.9% capacity and overflows were likely to happen. However, this was done strictly to lower Kelco's sewer bills.

Mr. Schachter asked Mr. Schlesinger about Kelco's influence on City government, in particular on elected officials. Mr. Schlesinger said Kelco was a "big player" but he is not aware of any political contributions being made by Kelco. Kelco did have access to the Mayor and Council.

Mr. Schlesinger was shown Exhibits 22-33:

- Exhibit 22 is an April 1, 1998 letter from Langworthy to McKinley regarding the method by which the City determines Kelco's level of suspended solids with attached SRF Agreement.
- Exhibit 23 is a September 29, 1998 letter from Steve Zapotieczny (Director, Environment, Safety and Health for Monsanto Company) to Schlesinger re: "Potential COD-Based Sewer Billing for Municipal Users."
- Exhibit 24 is an October 21, 1998 memo from Schlesinger to Distribution re: "Regional Wastewater Disposal Agreement – Review by State Water Resources Central Board."
- Exhibit 25 is an October 26, 1998 letter from Susan Hamilton (MWWD) to Zapotieczny re: "Cost of Services Study for Municipal Wastewater Services."
- Exhibit 26 is a November 12, 1998 email from Hanley to Loveland, Schlesinger and Hamilton ccing Phil Moffitt (Financing Services), Griffiths, Clay Bingham (Deputy Director of Parks and Recreation),

Bromfield and others re: "Meeting with Kelco – Strength Based Billing."

- Exhibit 27 is a November 18, 1998 document entitled, "Chronology of Correspondences between SWRCB and The City of San Diego."
- Exhibit 28 is a November 20, 1998 email from Moffitt to EZA re: "Strength Based Surcharge," attaching a November 20, 1998 email from Schlesinger to Eric Adachi (Financing Services) re: "Strength Based Surcharge," attaching a November 20, 1998 email from Loveland to Adachi re: "Strength Based Surcharge."
- Exhibit 29 is a November 24, 1998 letter from Hanley to McKinley re: "Strength Based Billing; Allocation Factors Based on Functional-Design Approach."
- Exhibit 30 is a December 14, 1998 letter from McKinley to Hanley re: "Specific Problems with Wastewater Strength-Based Cost Allocation Factors."
- Exhibit 31 is a January 5, 1999 letter from Hanley to McKinley re: "Wastewater Strength-Based Cost Allocation Factors."
- Exhibit 32 is a June 1, 1999 email from Schlesinger re: "Citizens Review Committee for Future Sewer Rate Increases."
- Exhibit 33 is a June 3, 1999 Manager's Report to the Honorable Mayor and City Council re: "State Revolving Fund Loan Program."

Regarding Exhibit 22, an April 1, 1998 letter from Langworthy to McKinley regarding the method by which the City determines Kelco's level of suspended solids with attached SRF Agreement, he stated that Section 6.10 is standard. Regarding Exhibit 24, an October 21, 1998 memo from Schlesinger to Distribution re: "Regional Wastewater Disposal Agreement – Review by State Water Resources Central Board," he said that he prepared the memo and did not want to sign an agreement with the PA's, begin SBB for them, and then have the State turn down the PA agreement. Regarding Exhibit 26, a November 12, 1998 email from Hanley to Loveland, Schlesinger and Hamilton, cc to Moffitt, Griffiths, Bingham, Bromfield and others, re: "Meeting with Kelco – Strength Based Billing," he said he did not know what "business sensitive" means. He did not know if he attended the meeting referenced. He would have attended the meeting if he was in town. Zapotichny is McKinley's superior. Kelco was very upset. Kelco saw the agreement with the PA's as a precursor for the City implementing SBB for Kelco. He convinced Loveland that SBB needed to be implemented for City users and Loveland agreed.

Regarding Exhibit 27, a November 18, 1998 document entitled, "Chronology of Correspondences between SWRCB and The City of San Diego," he said it was not prepared by Bromfield and he did not recall seeing it before. It would have been prepared as background for a City Attorney opinion. Bromfield probably asked for it. The first COS came out by November

1998 but was not made public. Bromfield prepared a City Attorney opinion regarding the COS. Schlesinger and Blair had a good relationship. Blair never asked him about the City implementing SBB.

Regarding Exhibit 28, a November 20, 1998 email from Moffitt to EZA re: "Strength Based Surcharge," attaching a November 20, 1998 email from Schlesinger to Adachi re: "Strength Based Surcharge," attaching a November 20, 1998 email from Loveland to Adachi re: "Strength Based Surcharge," he recalled sending it. Zapotichny, Kelco's CEO, warned Hanley to anticipate Kelco's actions. Schlesinger perhaps did not attend the meeting. Mr. Schlesinger said he did not support delaying the study or the rate case and wanted Hanley to know.

Regarding Exhibit 32, a June 1, 1999 email from Schlesinger re: "Citizens Review Committee for Future Sewer Rate Increases," Mr. Schlesinger said that the NR&C Committee was asking to delay the COS until the new election cycle. He said that the rate case has to show all types of revenue and expenses.

Regarding Exhibit 33, a June 3, 1999 Manager's Report to the Honorable Mayor and City Council re: "State Revolving Fund Loan Program," he said he was asking for authority to obtain a new SRF loan. He did not recall having discussions about whether San Diego could apply for a SRF loan while being out of compliance. There were public hearings before the State board to increase SRF to \$50 million but the issue of SBB was never discussed.

Mr. Schlesinger was shown Exhibits 34-41:

- Exhibit 34 is an October 20, 1999 email from Schlesinger to Zambrano, ccing Hanley, Kahlie, Loveland, and others re: "a couple of questions."
- Exhibit 35 is an October 20, 1999 email from Christine Ruess (Utilities Finance Administrator) to "dkk" re: "COS Studies."
- Exhibit 36 is a November 1, 1999 email from Schlesinger to Loveland ccing Hanley, Kahlie, Salt and others re: "Grand Jury Review of Sewer Rates."
- Exhibit 37 is a November 3, 1999 email from Schlesinger to Kahlie, Loveland, Michael Uberuaga (City Manager), Hamilton, Gammon and Hanley re: "Meeting with Chris Kehoe Nov 2 Re Cost of Services Study."
- Exhibit 38 is a November 3, 1999 email from Kahlie to CCP.MANAGER.GIL ccing "ptf" and "mev" re: "Meeting with Chris Kehoe Nov 2 Re Cost of Services Study -Forwarded," attaching a document entitled, "Discussion Outline Sewer Cost of Service Study Conclusions November 1, 1999."
- Exhibit 39 is a December 3, 1999 memo from Loveland to the Honorable Mayor and City Council re: "Wastewater System Financing Plan."

- Exhibit 40 is a February 4, 2000 email from Hamilton to Bromfield, Loveland, Schlesinger, Langworthy, and Stuart Wells re: "Mayor's Talking Points," attaching a document entitled,
- Exhibit 41 is a February 18, 2000 email from Hamilton to Bromfield, Loveland, jdragna@mdbe.com, Schlesinger, Scott Tulloch (Director of MWWD), Hanley, Langworthy and Stuart Wells re: "Final Recommended Letter," attaching a February 22, 2000 letter to Congressman Bob Filner from Susan Golding.

Regarding Exhibit 34, an October 20, 1999 email from Schlesinger to Zambrano, cc to Hanley, Kahlie, Loveland, and others, re: "a couple of questions," he said he probably discussed the questions with Loveland. He got along well with Loveland and Loveland did not "sugarcoat" his concerns. Regarding Exhibit 35, an October 20, 1999 email from Ruess to "dkk" re: "COS Studies," Ruess was an analyst in Financing Services and "Pat" is Pat Frazier. He said he spoke to Frazier one year earlier. At that time, Frazier made it clear to him that he was "outside his area of expertise." Frazier was a long-term employee and was very knowledgeable and smart. She could decide whether to increase or lower the amount of the bond issuance and did a much larger issuance than he had asked for and he could not spend all of the money raised. He told her it was a poor way of operating and that she should have told him before it happened. She told him that it was not his job to issue bonds, it was hers.

### *The Grand Jury*

Regarding Exhibit 36, a November 1, 1999 email from Schlesinger to Loveland, cc to Hanley, Kahlie, Salt and others, re: "Grand Jury Review of Sewer Rates, he said he is good friends with Barry Newman. Newman provided him with advice regarding the business side of issues and was very supportive of bond issuances. Newman was an attorney, a "big player" in San Diego, and was influential with the taxpayer's association. Newman called him regarding Kehoe and was aware of the need to implement SBB. The PA's were griping that they were being allocated for SBB but the City was not.

### *State's Knowledge of Noncompliance*

Regarding Exhibit 37, a November 3, 1999 email from Schlesinger to Kahlie, Loveland, Uberuaga, Hamilton, Gammon and Hanley re: "Meeting with Chris Kehoe Nov 2 Re Cost of Services Study," he did not think Blair thought the City was in compliance. The PA's had been under the SBB system for a year and it was possible that Blair did not know the City was not doing SBB or was out of compliance. The City was moving into compliance but it was taking too long. He did not remember discussions telling Blair one way or the other about the City's noncompliance.

Mr. Schlesinger was shown Exhibits 42-54:

- Exhibit 42 is an April 24, 2000 letter from F. Wayne Pierson to Schlesinger re: "Facility Plan Approval: City of San Diego (City) Point Loma Digesters C1 and C2 Upgrade Project, State Revolving Fund (SRF) Loan No. C-06-4718-110.

- Exhibit 43 is a June 13, 2000 email from Joe Harris to Kahlie, Frank Belock, Fritz Ortlieb (City Attorney's Office), Salt, Keri Katz (City Attorney's Office), Lisa Irvine (City Auditor's Office), Vattimo and Bromfield, ccing Hanley, Bill Lopez, Chris Toth and Schlesinger re: "Fwd: Review of RFP."
- Exhibit 44 is a June 28, 2000 email from Schlesinger to Kahlie and Vattimo re: "Sewer Cost of Service Study."
- Exhibit 45 is an August 21, 2000 letter from Bromfield to Hugh Barroll and Martin McDermott re: "City of San Diego v. Browner & EPA Proposed Settlement Terms."
- Exhibit 46 is a September 12, 2000 fax from Adachi to Sudhir Pardiwala & Prabha Kumar (Black & Veatch consultants) re: letters from Bill Hanley from the State concerning SBB.
- Exhibit 47 is a September 19, 2000 email from Schlesinger to Kahlie, Frank Belock, Ron Kole, Hanley, and Langworthy re: "'Dry Run' Meeting."
- Exhibit 48 is an email from Rashee Rohatgi to the Sewer Cost of Service Stakeholder's Group re: "Summary and agenda," attaching a September 14, 2000 meeting summary and agenda.
- Exhibit 49 is a September 29, 2000 email from Griffiths to Kahlie, Schlesinger, Hanley, Sharon Brown, and Langworthy re: "Stakeholders Meeting Sep 28 '00."
- Exhibit 50 is an October 9, 2000 email from Rohatgi to the Sewer Cost of Service Stakeholder's Group re: "Summary and tour itinerary," attaching a September 28, 2000 meeting summary.
- Exhibit 51 is a February 7, 2001 email from Schlesinger re: "Cost of Services Study."
- Exhibit 52 is a March 7, 2001 email from Schlesinger re: "Sewer Rates."
- Exhibit 53 is a March 7, 2001 email from Schlesinger to Kahlie, Tulloch, Hanley and Langworthy re: "3/15 Stakeholders' Meeting."
- Exhibit 54 is a March 7, 2001 email from Vattimo re: "Sewer Rates."

Mr. Schlesinger wanted Blair to know that the City was moving towards implementation of SBB so he invited him to a stakeholders' meeting. Regarding Exhibit 42, an April 24, 2000 letter from F. Wayne Pierson to Schlesinger re: "Facility Plan Approval: City of San Diego (City) Point Loma Digesters C1 and C2 Upgrade Project, State Revolving Fund (SRF) Loan No. C-06-4718-110," he wanted to obtain as many SRF loans as possible. Mr. Schachter asked Mr. Schlesinger if he felt it was appropriate to obtain SRF loans while out of

compliance. Since he felt SBB implementation was in process at the City, he said it was not inappropriate to ask for SRF loans when technically out of compliance.

Regarding Exhibit 44, a June 28, 2000 email from Schlesinger to Kahlie and Vattimo re: "Sewer Cost of Service Study," he thought Frazier and others were at the meeting with Kehoe but maybe it was just one meeting. Mr. Schachter asked Mr. Schlesinger to explain Exhibit 44. He said he did not want to go through another rate increase and another bond issuance. If he received SRF money, he would not need to. No one wanted to raise rates. He asked when the nominees for the stakeholders' group would be chosen because it was taking a long time.

Mr. Schlesinger was shown Exhibits 55-62.

- Exhibit 55 is a March 14, 2001 memo from City Attorney to See Distribution re: "Prop 218 Decision on Water Fees."
- Exhibit 56 is a March 20, 2001 email from Loveland re: "Sewer and Water Rate Increase."
- Exhibit 57 is an April 11, 2001 email from Salt to Schlesinger and Loveland, cc to Kahlie, Gardner, Vattimo and others re: "218 Notice."
- Exhibit 58 is a November 2, 2000 SRF loan contract for Loan No. C-06-4718-110.
- Exhibit 59 is an August 12, 2003 email from Tulloch to Richard Mendes (Deputy City Manager), Kahlie, Hanley, and Tom Story (Senior Policy Advisor to Mayor Murphy) re: "BOD Charges for Sewer Cost of Services Study," attaching an August 12, 2003 email from Schlesinger to wst@sandiego.gov, cc to axl@sandiego.gov and wzh@sandiego.gov re: "BOD Charges for Sewer Cost of Services Study."
- Exhibit 60 is a September 10, 2003 email from Schlesinger to Bob Pruitt and others re: "BOD Sewer Charge: Follow-up meeting – Wednesday, September 10, 9:15 a.m."
- Exhibit 61 is a September 11, 2003 email from Schlesinger to JNHarris@sandiego.gov, cc to wst@sandiego.gov, wzh@sdcity.sannet.gov, and axl@sandiego.gov re: "BOD Sewer Charge: Follow-up Meeting – Wednesday, September 10, 9:15 a.m."
- Exhibit 62 is a March 5, 2004 email from Tulloch to Schlesinger and Langworthy re: "Bajagua."

Regarding Exhibit 52, a March 7, 2001 email from Schlesinger re: "Sewer Rates," Mr. Schlesinger said that the sewer rate increase was separate and apart from changing the sewer rate structure. He wanted to wait to see what the third COS said. Regarding Exhibit 54, a March 7, 2001 email from Vattimo re: "Sewer Rates" he said he did not get along well



with Vattimo. He was good friends with Kahlie and felt that Kahlie was a "straight shooter." Kahlie was not viewed as being very politically sensitive but is a "good guy."

Regarding Exhibit 58, a November 2, 2000 SRF loan contract for Loan No. C-06-4718-110, Mr. Schachter asked Mr. Schlesinger why he signed Exhibit 58 given the City was out of compliance. He replied that he believed Section 11 of the SRF loan contract was correct and therefore signed off on it. He did not think of it in the context of the COS. He did not give it much thought. Had San Diego been turned down because of a lack of compliance he would not have submitted the application.

### ***Post-Retirement***

Regarding Exhibit 60, a September 10, 2003 email from Schlesinger to Bob Pruitt and others re: "BOD Sewer Charge: Follow-up meeting – Wednesday, September 10, 9:15, a.m.," he said that after he retired, the Chamber asked him to serve on the infrastructure committee. Bob Pruitt chaired a subcommittee that dealt with water and sewer issues and asked him about the sewer issues. The Chamber typically lobbies for business. He provided background information and recommended the committee be made aware of the history.

### ***Schlesinger's Comments***

Mr. Schachter asked Mr. Schlesinger if there was anything we did not cover during the interview that Mr. Schlesinger felt was important for us to know. He said we should talk to people outside the City including Newman, Jay Golby (Chair of the PA Commission), Augie Kerries (technical advisor of the PA's), and Mathis and Stallings. He was not sure the City was totally at fault. They aggressively went after SRF loans and paid them back. The City did not do SBB as quickly as possible but he generally felt they were doing the right thing. He believes the City employees are really honest and he was really strongly opposed to right-of-way fees and found them "beyond the pale." Hanley was the closest person on the "day to day" stuff and Bromfield was the key person in the City Attorney's Office on these issues.

### ***Conclusion***

Mr. Schachter asked if Mr. Schlesinger was aware of any conduct of city employees that was deliberately dishonest or knowingly improper. Mr. Schlesinger said no but that some people make "judgment calls." Mr. Schachter requested that Mr. Schlesinger keep the interview confidential.

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